THE PATENT LAW AND THE SHERMAN LAW.

THE grant of a patent gives the monopoly by a patentee for seventeen years in the making, using and selling of his invention. The acts of Congress under the authority of the Constitution so provide. The Sherman Law specifically denies any right of a monopoly or an attempt to monopolize on the part of any citizen or group of citizens; it forbids a combination or conspiracy with monopoly as its ultimate end; contracts, combinations, trusts or conspiracies restraining interstate trade are expressly prohibited.

The courts have found it a problem to reconcile several phases of these two apparently conflicting acts of Congress, the Patent Act and the Sherman Anti-Trust Act, and the public has found much uncertainty in the state of the law. The reconciliation of these two acts of Congress, the one granting and the other prohibiting monopolies, has had an interesting history in the federal courts. By reason of the fact that the Supreme Court of the United States has recently passed upon several of the phases of the question, and by reason of the fact that a number of bills, particularly the Oldfield bill, have been prominently before Congress, a question of the extent of the application of a patent monopoly in the face of the prohibition of any monopoly is a vital one. It is a question of what is the status of combinations whose businesses are based on patent rights and mechanical ideas protected by this monopoly granted by the government.

The fundamental idea in combinations founded on patent rights is that the patentee has a right to dispose of part or all of his rights under the patent grant either by a license contract, limited or exclusive, or by an assignment of all his interest.[1] He may not use it himself at all and he can forbid others to derive any advantage from it; he may lock it up for seventeen years so far as the public is concerned and there will be no ground of recognizable complaint.[2] The patentee's control is exclusive

[1] Paper Bag Cases (1881), 105 U. S. 766.

[2] Connally *v.* Union Sewer Pipe Co. (1901), 184 U. S. 546.

and apparently complete in return for his revelation of his invention.

The Question.

What effect does the patent monopoly have upon the avowed intention of the government to forbid all monopoly?

The Patent Law.

At common law, the inventor possessed the naked right to make, use and sell his invention.[3]

The statute grants the exclusive right to make, use and sell the invention. The United States Revised Statutes, § 4884, provides that a patent is:

> "A grant to the patentee, his heirs or assigns, for the term of seventeen years, of the exclusive right to make, use and vend the invention or discovery throughout the United States, and the territories."

The Sherman Law.

The United States statute, dated July 2, 1890, commonly known as the Sherman Anti-Trust Act,[4] among other things, provides as follows in:

> "Sec. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court."

and also in

> "Sec. 3. Every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce, is hereby declared illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding

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[3] Bauer & Cie *v.* O'Donnell (1912), 229 U. S. 1.

[4] Act of July 2, 1890, 26 Stat. 209, c. 647.

> five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court."

This presents the apparently opposing statutes.

THE ATTITUDE OF THE SUPREME COURT.

The Supreme Court of the United States in United States *v.* American Tobacco Company,[5] has expressed its present view as to combinations in restraint of trade in the following language by Mr. Chief Justice White:—

> "In other words, it was held not that acts which the statute prohibited could be removed from the control of its prohibitions by a finding that they were reasonable, but that the duty to interpret which legitimately arose from the general character of the term restraint of trade required that the words restraint of trade should be given a meaning which would not destroy the individual right to contract and render difficult, if not impossible, any movement of trade in the channels of interstate commerce—the free movement of which it was the purpose of the statute to protect."

And it was further said "that in view of the general language of the statute and the public policy which it manifested, there was no possibility of frustrating that policy by resorting to any disguise or subterfuge of form, since resort to reason rendered it impossible to escape by an indirection the prohibitions of the statute."

The court thus indicated its desire to permit the greatest freedom of contract, necessary through trade, or necessary by reason of a specific statute of the United States.

The court also said that any combination was illegal if it included the prohibited elements, notwithstanding any "resort to any disguise or subterfuge of form." The court, therefore, intends to construe the statute in order to allow the greatest freedom for legitimate enterprise and to regard the ultimate result of the enterprise, irrespective of the form or method or lawful means by which the ultimate result is achieved. Good motives

[5] (1910) 221 U. S. 106.

are no excuse for evasion of the intent of the Sherman Law.[6] License agreements may have any conditions "not definitely illegal." [7]

THE LAW.

In late years the question of the combination of manufacturers, or users of patent devices, under patents, has been before the courts frequently in various forms. A review of the leading cases so far decided is essential to an understanding of the final doctrine which is in vogue at present with regard to the extent of the effect of the Sherman Law on the Patent Law.

I.

First, the decisions in the lower federal courts will be considered.

In National Harrow Company *v.* Hench,[8] a number of manufacturers organized a corporation and assigned to it all their patents then owned or to be thereafter acquired, and the good will of their business, and agreed not to interest themselves in the manufacture or sale of such harrows except as agents or licensees of the holding corporation, and agreed that the corporation should license them to manufacture and sell for their own account, subject to certain uniform regulations and terms, and agreed that each licensee should pay $1 for each harrow manufactured, and should receive paid up stock in return for the patents and good will transferred to the holding corporation. Manufacturers representing 70 per cent of the total manufacture and sale of the commodity in the United States went into the agreement. The licensees also bound themselves not to cut prices. It was held that this was a combination in unlawful restraint of trade and that even though it was true that a number of patentees were exposed to litigation, justifying them in adjusting their differences, yet that fact could not be made the excuse for the creation of a monopoly to the public disadvantage.

[6] U. S. *v.* Trans-Missouri Freight Assn. (1896), 166 U. S., 290; Armour Packing Company *v.* U. S. (1907), 209 U. S. 56, 62; Standard Manufacturing Co. *v.* U. S. (1912), 226 U. S. 49.

[7] Bement *v.* Harrow Co. (1901), 186 U. S. 70, 91.

[8] (C. C. A., Third Circuit, 1897), 83 Fed. 36.

To practically the same effect is Harrow Company *v.* Quick.[9] In National Harrow Company *v.* Hench, *et al.*,[10] where there was a combination among manufacturers of spring tooth harrows, as a result of which a corporation was organized for that particular purpose, and which became the assignee of all patents owned by a number of these manufacturers, and then executed licenses to them to manufacture under these patents, with the consequence that this combination, headed by the corporation holding the basic patents, controlled the entire business and enhanced the price, it was held void both as to the assignments of the several manufacturers to the holding corporation and as to the licenses granted by the corporation back to the manufacturers. The net result was that the corporation was unable to maintain a suit against one of its assignors, who violated the agreement, on the ground of infringement.

This case was one of a number prosecuted by the National Harrow Company, the holder of the patents by assignment and the grantor of the licenses to the various manufacturers. This same party finally was before the Supreme Court of the United States in Bement *v.* National Harrow Company.[11] By reason of the peculiarity of the record which only showed plainly certain license agreements between the National Harrow Company and Bement, the court refused to hold anything except that the specific contract between the harrow company and Bement was valid. It intimated, but would not decide, that the entire situation would have been different if the record had clearly presented a combination or an attempt to monopolize by the gathering of all the patents into the hands of one party and in the licensing of a great number of others by that holder of the patents. This was not shown and the question of the legality of the combination, whether illegal or not, was not passed upon. The court since then has frequently referred to this case and has always defined its boundaries very clearly and carefully.

In United States Consolidated Seeded Raisin Company *v.* Griffin & Skelley Company,[12] where there were contracts by which a

[9] (C. C. D. Ind., 1895), 67 Fed. 130.
[10] (C. C. N. D. New York, 1898), 84 Fed. 226.
[11] (1901) 186 U. S. 70.
[12] (C. C. A. Ninth Circuit, 1903), 126 Fed. 364.

number of patents, covering many similar inventions, were conveyed by their several owners to one of the parties, and where that party granted a license under all the patents to the others, it was held that this was not void as against public policy or because in violation of the Sherman Anti-Trust Law, by reason of the fact that the provisions of the contracts were intended to protect and maintain the patent monopoly by requiring the licensor to prosecute all infringers, limiting the licenses to be granted to such licensees as were agreed on and imposing on each licensee certain conditions as to the use and ownership of the patented machines and prohibiting them from using any others.

In Rubber Tire Wheel Company *v.* Milwaukee Rubber Works Company,[13] where there were a number of contracts between the owner of a patent for rubber tired wheels and its licensees, whereby prices were made uniform and the percentage of the whole output which should be made and sold by each licensee was regulated, and it was provided that the business of each one should be supervised by commissioners appointed by the licensor, and there was a provision for the accumulation of a fund by the commissioners with power in them to use the same, with the consent of the majority, in the purchase of tires from any or all of the licensees and to sell the same at such prices as they should deem for the best interests of all, it was held, reversing the lower court, that these contracts were perfectly valid.

In Blount Manufacturing Company *v.* Yale & Towne Manufacturing Company,[14] there were a number of contracts between manufacturers of door checks which restrained each one of the parties to the contracts in the exercise of their rights under their own patents, and in the sale of the articles made under such patents; these contracts also authorized each of the parties to use the patented inventions belonging to the others who were parties to the contracts. This was held to be in restraint of interstate commerce and invalid. Judge Brown laid down very clearly in an able opinion the fundamental doctrine in all these cases, namely, that while it is the statutory privilege of the owner of the patent to make, use and sell his invention as he pleases with-

[13] (C. C. A. Seventh Circuit, 1907), 154 Fed. 358.
[14] (C. C. D. Mass., 1909), 166 Fed. 555.

out being questioned as to his motive, yet the patentee has no right to make the use of his invention as an excuse to restrain the trade in that article in a purely commercial way except as might be necessary in connection with an assignment of the rights covered by the patent to protect the value of what was granted. In this particular case the agreement was held invalid because it constituted a general plan to regulate and control business—it was a commercial expedient primarily. So to maintain the price, pool the profits, eliminate competition, and restrain improvements and generally interfere with interstate commerce, was to constitute a violation of the Sherman Anti-Trust Act. It was pointed out that a patented article might be sold or licensed with a covenant not to compete with the manufacturer as an ordinary incident to increase the value of the thing conveyed and that this would not be within the prohibition of the Sherman Anti-Trust Act because of the basic reason that this was a necessary incident to the patent grant.

Judge Brown said:

> "Combinations between owners of independent patents, whereby, as part of a plan to monopolize the commercial field, competition is eliminated, are within the Sherman Act, for the reason that the restraint of trade or monopoly arises from combination, and not from the exercise of rights granted by letters patent. If by the terms of the contracts under consideration the owner of distinct patents has agreed to restrain its own interstate trade, I am of the opinion that the contracts will in these particulars be obnoxious to the Sherman Anti-Trust Act."

In Indiana Manufacturing Company *v.* Threshing Machine Company,[15] the complainant was the owner of a number of patents relating to pneumatic straw stackers, and granted licenses to manufacturers of threshing machines by virtue of which they were given the right to use any or all inventions covered by such patents and were required to sell stackers made under such patents at a stated price and to pay the complainant, the owner of the patents and the licensor, a royalty on each stacker so made and sold. These licensees were also given the right to use in-

[15] (C. C. A. Seventh Circuit, 1907), 154 Fed. 365.

ventions covered by any other patents relating to the art which should happen to be acquired by the complainant, who was the licensor in this case, and this complainant did acquire the ownership of practically all the patents relating to such stackers; it practically acquired everything in the art. It was held that such contracts were not in restraint of competition and not in violation of the Sherman Anti-Trust Act, but were well within the right of the holder of the patents under the patent laws, for the reason that the public had no right to a free competition in the articles covered by the patents because the government had specifically granted a monopoly for a certain period in those articles and if the owner of them had so desired he could have kept them from the public altogether during the monopoly. Whatever was granted was just so much more to the benefit of the public and if they did not get everything that might have been granted, they had no right to complain for they had no right to demand.

So much for a brief survey of the earlier cases in the district courts and circuit courts of appeals. Throughout the whole line of cases it will be seen that one principle runs as the basic consideration behind all the decisions. This principle is that where a patentee merely takes such steps as are necessary to protect himself in the full enjoyment of the rights incident to his patent monopoly, then he is well within the province of his right; but if he attempts to use the patented article or the letters patent as an excuse for a combination or conspiracy to restrain trade even in the patented, then he comes within the purview of the Sherman Anti-Trust Law.

II.

Secondly, as to the cases which have been passed upon by the Supreme Court of the United States.

In Bement *v.* National Harrow Company,[16] as stated above, the license contracts in question between the Harrow Company and Bement were the only ones actually concretely presented to the court. There was some evidence of other contracts, but the evidence failed to prove a great number or even more than one, of these license contracts. The court therefore actually passed upon

[16] (1901) 186 U. S. 70.

no question except the specific one presented for its determination, namely, whether the contracts between Bement and the National Harrow Company were of such nature to constitute a monopoly and a restraint upon interstate trade. This case is sometimes quoted by the courts as deciding the proposition that a whole group of license contracts under those circumstances would not constitute restraint of trade. This is error. The court in subsequent decisions has specifically pointed out that they only passed upon the exact question, and have taken pains to hedge the case about with all the limitations possible without actually reversing it so that it is now confined to the single proposition, that the contracts between Bement and the harrow company were not of such a character as to be unlawful.[17] As the court said:

> "There is no finding between referees that this agreement was ever signed by any one other than the parties to this action, or that any other person received the licenses from and made contracts with the plaintiff similar to the ones entered into between these parties."

The court's test of the nature of a license contract, and what its ultimate effect must be in order to place it within the prohibition of the anti-trust law, is also found in the following sentence.

> "These contracts" (referring to contracts which were found invalid in other cases) "directly effected, not as a mere incident of manufacture, the sale of the implements all over the country, and the question arising is whether the contracts which thus effect such sales are void under the acts of Congress."

The contracts which are thus used primarily as instruments to restrain trade, rather than to protect the legitimate rights incident to and inherent in a patent monopoly, are prohibited.

In Standard Sanitary Manufacturing Company *v.* United States,[18] a party named Wayman persuaded the owner of a patent on a tool, by which an even coat of enamel could be applied to plumbing fixtures, to transfer it to him. This patent was a fundamental one and permitted a vast improvement in the art of making such enamel ware. Wayman also acquired two other

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[17] **Standard Manufacturing Co. *v.* U. S. (1910), 226 U. S. 48.**
[18] **(1910) 226 U. S. 20.**

patents of similar nature about whose validity there was some question in view of the basic patent. Using these patents as an excuse for a trade combination in which prices were to be maintained at a certain point, license agreements were made with a great number of manufacturers, controlling about 85 per cent of the output, who subscribed to the articles of the association, restrictions were placed upon sales to jobbers and a policy adopted for the exclusion from the trade of all those who would not subscribe to the conditions imposed upon them by the manufacturers, and other means looking to the total exclusion of those who did not support the combination were effected. The total result of the agreement was to control, first, the patented tool, and second, the main effect was to control through this patented tool the unpatented output. In other words, the patent was made merely an excuse for a combination in restraint of trade, and the license agreements were not entered into solely for the purpose of securing to those entitled to them the legitimate results of the patent monopoly. The Supreme Court therefore held that it was a case which was within the prohibition of the anti-trust law and without the protection of the patent law. The contracts had passed the dividing line. Therefore, the control, through this protection of a patented article, over unpatented articles manufactured in part by a patented tool was in contravention of the anti-trust law. There was some claim on the part of the defendants that they could and would eliminate "seconds" by the universal use of this patented tool, therefore improving the quality of the product and correspondingly benefiting the public. The court seemed to take the view that this was merely an excuse without much material weight because of the fact that in the original agreement the licensee referred to "seconds" in two lines in the contract. This was the total reference to what was claimed as the most material point in the whole agreement.

In this case Mr. Justice McKenna reiterates the attitude of the court upon this question:

> "And we shall keep in mind and apply the principle expressed in Bement *v.* National Harrow Company, 186 U. S. 70, 92, that the Sherman Law 'clearly does not refer to that kind of interstate commerce which may arise from reason-

> able and legal conditions imposed upon the assignee or licensee of a patent by the owner thereof restricting the terms upon which the article may be used and the price to be demanded therefor. Such a construction of the act we have no doubt was never contemplated by its framers.' "

It is interesting to note that the court refused to go "into the consideration of the distinction of rights for which the Government contends between a patented article and a patented tool used in the manufacture of an unpatented article."

Suggestive Cases.

Several recent cases decided by the Supreme Court are interesting in the side lights they throw on the precise question at hand. In Henry *v.* Dick Company,[19] it was held that where a patented mimeograph had been sold which had an inscription in the form of a notice that the machine was sold with a license restriction that it might be used only with stencil, ink and other supplies made by the A. B. Dick Company, the owners of the patent; and an alleged infringer sold to the purchaser of the mimeograph a can of ink suitable for use with the machine with full knowledge of the restriction and with the expectation that the ink sold would be used in connection with the machine, the profit of the entire transaction being derived solely from the sale of the unpatented article by the manufacturer of the patented machine, such action by the person selling these unpatented articles to the purchaser of the patented mimeograph constituted contributory infringement of complainant's patent.

In Bauer & Cie *v.* O'Donnell,[20] where a patentee attempted by notice to limit the price at which the future retail sales of his medicine should be made, the article being in the hands of a retailer by purchase from a jobber who paid the agent of the patentee the full price asked, it was held that the patentee could not thus control the retail price by notice.

In Miles Medical Co. *v.* Park & Sons Co.,[21] specifically pointed out that in the case of an unpatented medicine a combination whose sole purpose was to destroy competition and to fix prices

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[19] (1911) 224 U. S. 1.

[20] (1912) 229 U. S. 1.

[21] (1910) 220 U. S. 373.

was void because injurious to the public interest and was not saved by the advantages to the producer from enhanced prices to consumer. The case arose in an attempt to eradicate the "cut rate" drug store; the Bauer Case had a similar origin. As to this doctrine Mr. Justice Hughes remarked:

> "The complainant having sold its product at prices satisfactory to itself, the public is entitled to whatever advantage may be derived from competition in the subsequent traffic."

Furthermore, if a patentee passes title to the purchaser of his patented article, he thereby places the article beyond the monopoly secured by the patent act.[22] These cases are interesting phases of the problem of price control.[23] In the very recent case of Ford Automobile Co. *v.* International Automobile League, *et al.*,[24] it was pointed out that a patentee could not restrict the price at which his patented article should be sold by means of a license agreement between himself and his dealers with the result of binding a purchaser in good faith who bought from the dealer.

In Virtue *v.* Creamery Package Company,[25] the Supreme Court held there was no violation of the anti-trust law. The following facts were involved:

1. Three companies were in the field making and selling churns and butterworkers. These were the Drisbrow Company, the Owatonna Company and the Creamery Package Company.

2. Drisbrow had patent litigation against Owatonna. Owatonna had patent litigation against Drisbrow. They settled, Owatonna taking the license from Drisbrow under the patents.

3. Drisbrow and the Creamery Company had a patent controversy of some kind.

4. Owatonna appointed the Creamery Company exclusive sales agent, enumerating the patents.

5. Drisbrow also made Owatonna its sales agent.

6. The Creamery Company and the Owatonna Company sued Virtue for infringement and Virtue claimed that the com-

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[22] Adams *v.* Burke (1873), 17 Wall. 453.

[23] Kellog Toasted Corn Flake Co. *v.* Buck (D. C. S. D. Cal., 1913), 208 Fed. 383.

[24] (1913) 209 Fed. 235.

[25] (1912) 227 U. S. 8.

plainants and Drisbrow were violating the anti-trust law by reason of these license contracts.

The court affirmed the lower court, holding that there was no violation of the anti-trust law by reason of these patent license arrangements.

THE TEST.

The doctrine of the law is now becoming defined. The attitude of the courts has gradually moulded a legal test. The rule by which a determination can be made whether a combination is in restraint of trade or not is this, after considering what the ultimate object is and what the result for the public will be, is the combination by virtue of license agreements, contracts or assignments, such a one as is essential to protect the patent rights involved, or is it a means to create a commercial combination, with commercial objects primarily in view, using the patent rights as the basis, or as the excuse, or as the cloak behind which the real object is accomplished? The answer to this question will bring the answer to the question whether the proposed combination is within the rights granted by the patent law or within the prohibitions of the Sherman Anti-Trust Law.

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